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To Electricity Distribution
Network Operators

Direct Dial: 0141 341 3997

Email: RIIOED2@ofgem.gov.uk

Date: 19 June 2023

Dear licensee,

Background

We[1] published our RIIO-ED2 Final Determinations on 30 November 2022.[2] These included our decision to introduce a new DSO financial incentive to drive Distribution Network Operators (DNOs) to more efficiently develop and use their network, taking into account flexible alternatives to network reinforcement.

As part of that decision, we decided to implement three outturn performance metrics:

- **Flexibility reinforcement deferral (FD$_t$)**, which will drive DNOs to use flexibility to address network constraints when it is the most economic solution;

- **Secondary network visibility (NV$_t$)**, which will promote visibility and accuracy of utilisation of Pole Mounted Transformers and Ground Mounted Transformers; and

- **Curtailment efficiency (CE$_t$)**, which will incentivise DNOs to limit curtailment of users on curtailable connections resulting from actions taken to restrict the conditions of a connection (import and / or export capacity) in response to a constraint on the distribution system.

We decided not to implement targets for the outturn performance metrics in Year 1 of RIIO-ED2. This means that performance against them is not currently subject to any financial incentive. Instead, we said that we would work with the DNOs to gather

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[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.
[2] RIIO-ED2 Final Determinations | Ofgem

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performance data on the metrics to help inform target setting, before applying financial rewards / penalties to performance from Year 2 onwards (subject to licence area specific targets being set).

Target setting process

This letter sets out the process with respect to setting the targets for the three outturn performance metrics.

Instructions for completing the outturn performance metrics worksheets are set out in Annex I – DSO, which is part of the RIIO-ED2 Regulatory Instructions and Guidance (RIGs). We have recently consulted on these and published our decision.[3] DNOs should therefore submit the information requested in this letter in accordance with the version of the RIGs published on 19 June 2023.

In addition to the RIGs, the DSO Incentive Governance document defines the processes and criteria used to assess performance; the reporting requirements; and the methodology we will use to determine an incentive reward or penalty.[4] We recognise that the final decision on RIGs might mean that changes to the DSO Incentive Governance document are needed to make sure they remain aligned (eg, the definition of RRE2). We will keep this under review and update on any plans to consult on an updated DSO Incentive Governance document once the RIGs consultation has closed.

Licensee(s) are required to submit the following information by 17 July 2023:

- Forecasts, for the Regulatory Year 2023/24, for the secondary network visibility (NVt) metric (monitored sites only) and RRE 2: primary network forecasting accuracy. Further details are set out in Annex I of the RIIO-ED2 RIGs; and
- Projections of actual outturn performance, for the Regulatory Years 2023/24 to 2027/28 inclusive, for the flexibility reinforcement deferral (FDt), secondary network visibility (NVt) and curtailment efficiency (CEt) metrics. Further details are set out in Appendix 1 which is attached to this letter.

We welcome views on sensitivities and the margin of error within the information submitted, as well as any difficulties licensees have found when looking at this. We also invite any views on how this can be managed when setting targets, deadbands and or maximum reward/penalty scores.

Following receipt of this data, we will:

- Arrange a series of working groups, in late summer 2023, to discuss proposals for outturn performance metrics target setting. This will include consideration of the

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[3] Notice to issue regulatory instructions and guidance under the electricity distribution network operators price control RIIO-ED2 | Ofgem
[4] Decision on the proposed modifications to the RIIO-2 Electricity Distribution licences | Ofgem

appropriate target, deadband(s) and maximum reward/penalty score(s) for each metric;

- Consult on the draft targets, deadband(s) and maximum reward/penalty score(s) before publishing a decision in winter 2023; and
- Implement our decision for Year 2 of RIIO-ED2 via the statutory modification process.

Next steps

The information described in Appendix 1, attached to this letter, must be sent to RIIOED2@ofgem.gov.uk by no later than 5pm on 17 July 2023.

If you have any questions concerning this letter then please contact zoe.cornish@ofgem.gov.uk.

Yours faithfully,

David McCrone

Head of ED2 Quality of Service, Networks

Appendix 1

Licensee(s) are required to provide data as specified in the subsidiary spreadsheet (Appendix 1_DSO metric target setting template) published alongside this letter.